Duquesne Law Review

Volume 17 | Number 1 Article 20

1978

Taxation - Inclusions in Gross Income - Cash Allowances for State Troopers

Marilyn Kay Josephs

TAXATION — INCLUSIONS IN GROSS INCOME — CASH ALLOWANCES FOR STATE TROOPERS — The United States Supreme Court has held that cash allowances paid to state troopers for meals while on duty must be included in gross income under section 61 of the Internal Revenue Code and cannot be excluded by section 119.

Commissioner v. Kowalski, 434 U.S. 77 (1977).

During the 1970 tax year,[1] the taxpayer, a New Jersey state trooper, filed a federal income tax return that included as gross income only part of the cash meal allowance paid to him by the state.[2] In an audit of his return, the Commissioner of Internal Revenue determined that the total amount of the meal allowance was required to be included in gross income and, a deficiency was assessed.[3] The taxpayer, Robert J. Kowalski, sought review of the Commissioner's decision in the Tax Court of the United States.[4] The tax court affirmed the Commissioner's decision[5] that the payments

1. Prior to July, 1949, all New Jersey state troopers were supplied with meals at meal stations throughout the state while on duty. The system proved unsatisfactory because the troopers had to leave their posts unguarded for approximately one and a half hours while going to a meal station. Because of this problem, the state discontinued its meal operation and instituted a meal allowance system whereby each trooper was given a cash allowance for meals. These were advance payments, made biweekly along with the trooper's salary, designated as a meal allowance, and separately accounted for in the state police accounting system. Comm'r v. Kowalski, 434 U.S. 77, 80 (1977).

2. Since the division of State Police began to withhold income tax from cash meal allowances on October 1, 1970, only $325.45 of Kowalski's cash allowances was reported by the state on his Wage and Tax Statement. *Id.* at 81.

The general definition of gross income is provided in I.R.C. § 61(a), which states that "[e]xcept as otherwise provided . . . gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items . . . ."

3. 434 U.S. at 81. If a taxpayer is audited and the I.R.S. determines that there is an error that, when corrected, would result in a greater tax liability, the taxpayer will be assessed the difference. If the taxpayer disputes liability for the additional sum, he may file a petition with the United States Tax Court for a redetermination of the deficiency. I.R.C. § 6213.

4. 434 U.S. at 81. On review in the tax court, Kowalski v. Comm'r, 65 T.C. 44 (1975), Kowalski argued that the meal allowance was furnished for the "convenience of the employer" and was therefore noncompensatory within the meaning of the "convenience of the employer" doctrine. *See* note 9 *infra.*

5. The tax court dismissed the argument that Saunders v. Comm'r, 215 F.2d 768 (3d Cir. 1954), controlled, stating that *Saunders* was decided prior to the 1954 Code. The court concluded that even though the meal allowance was not intended to be additional compensation, it was compensatory to a trooper to the extent that it paid for food which he otherwise would have been required to pay for from some other source. The Tax Court was also influenced by the fact that troopers were permitted to bring their lunches and eat them in or near their patrol cars and still receive the same meal allowance. 65 T.C. 44, 51-52 (1975).

were to be included in gross income under section 61(a) of the Internal Revenue Code, and further held that they were not to be excluded under section 119.[6] The United States Court of Appeals for the Third Circuit reversed,[7] *per curiam,* concluding that on the basis of its decision in *Saunders v. Commissioner,*[8] the "convenience of the employer" doctrine[9] is the key criterion for determining whether cash allowances are excludable from gross income. Since the cash meal allowances were for the employer's convenience, the Third Circuit held in favor of the taxpayer.

In order to resolve a conflict among the circuits[10] on this question, the United States Supreme Court granted certiorari.[11] The majority, in an opinion by Justice Brennan, reversed the court of appeals, holding that the meal allowance must be included in gross income under section 61, since the payments were accessions to wealth, clearly realized, over which the taxpayer had complete dominion.[12]

---

6. 434 U.S. at 81. I.R.C. § 119 provides in pertinent part:

> There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, but only if—
>
> (1) In the case of meals, the meals are furnished on the business premises of the employer . . . .
>
> In determining whether meals . . . are furnished for the convenience of the employer, the provisions of an employment contract or state statute fixing terms of employment shall not be determinative of whether the meals . . . are intended to be compensation.

7. Kowalski v. Comm'r, 544 F.2d 686 (3d Cir. 1976).

8. 215 F.2d 768 (3d Cir. 1954). The Third Circuit in *Saunders* held that the rationale of the convenience of the employer doctrine, *see* note 9 *infra,* made the doctrine applicable to determine the extent of gross income received either when quarters or meals are furnished in kind or when cash is paid in lieu thereof. The court also held that an employee may be furnished with cash that is not compensation in the same way he is often furnished with tangible property that cannot be regarded as compensation. 215 F.2d at 77.

9. This doctrine stands for the proposition that benefits conferred upon an employee by an employer primarily for its own convenience, rather than for the convenience of the employee, are not income within the meaning of the Internal Revenue Code. This specific exemption is found in a line of lower court cases and administrative rulings. *See* notes 20 and 21 *infra.*

10. 434 U.S. at 82. *See, e.g.,* Wilson v. United States, 412 F.2d 694 (1st Cir. 1969) (cost of meals repaid to policemen by the state of New Hampshire required to be included in the taxpayer's gross income); United States v. Keeton, 383 F.2d 429 (10th Cir. 1967) (monthly cash allowance for meals paid by the state of Colorado to highway patrolmen not required to be included in the taxpayer's gross income); United States v. Barrett, 321 F.2d 911 (5th Cir. 1963) (repayments for meals made to Mississippi highway patrolmen were excludable from the taxpayer's gross income); Magness v. Comm'r, 247 F.2d 740 (5th Cir. 1957) (subsistence allowance paid to members of Georgia state highway patrol was held to be includable in the taxpayer's gross income).

11. 430 U.S. 944 (1970).

12. 434 U.S. at 83 (citing Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955)).

The Court also held that the meal allowance could not be excluded by section 119.

In reaching its decision, the Court rejected the two main contentions proffered by the taxpayer in support of exclusion:[13] 1) that section 119 specifically exempts the meal allowance payments from gross income, and 2) that notwithstanding section 119, a specific exemption may be found in lower court cases and administrative rulings establishing the "convenience of the employer" doctrine. In dismissing the taxpayer's initial contention, the Court asserted that section 119, by its terms, covers only *meals* furnished by an employer, and not cash reimbursements for meals.[14] The Court elaborated on the distinction between in-cash and in-kind allowances by discussing the technical appendix to the Senate Report,[15] which stated that section 119 applies only to meals furnished in kind and not to cash allowances *to the extent that they represent compensation.*[16] The taxpayer's theory that this language recognized the existence of a class of noncompensatory cash payments was rejected by the Court,[17] based on its observation that if cash reimbursements could be excluded by merely showing that such payments were for the employer's convenience, then cash would be more widely excluded from gross income under section 119 than meals in kind.[18] This, the Court suggested, would be an extraordinary result given the presumptively compensatory nature of cash payments and the intent of Congress in enacting section 119 to narrow the circumstances in which meals could be excluded from gross income.

The Court also rejected the taxpayer's second argument after surveying the development of the "convenience of the employer"

13. 434 U.S. at 84-95.

14. *Id.* at 84.

15. S. REP. No. 1622, 83d Cong., 2d Sess. (1954). The Senate Report documented the legislative discussion concerning the proposed scope and application of section 119.

16. The Court interpreted Congress' statement to mean that only meal payments deductible under § 162(a)(2) of the Code could be excluded. *See* note 36 *infra.*

17. 434 U.S. at 94.

18. The Court may have been apprehensive that if cash reimbursements for meals could be excluded in this way, employers would bargain with employees to pay them less salary and more for meal allowances. In such case, the employer might be able to pay a lower combined pre-tax salary and meal allowance which would yield higher after tax proceeds, since the employee would not be taxed on the meal allowance. Consequently, both employee and employer would benefit.

doctrine.[19] The Court traced the administrative rulings[20] that established the doctrine, as well as the vast body of case law[21] that applied the doctrine, and determined that by enacting section 119, the Senate[22] intended to replace all of the prior administrative rulings and case law. The majority refused to completely abandon the "convenience of the employer" doctrine, however, since the Senate chose to use the words "convenience of the employer" in describing a condition for exclusion under section 119. In addition, the Court stated that the term was intended to be adopted as it had developed over time.[23]

The Court summarily rejected the taxpayer's final argument that it is unfair that members of the military can exclude allowances for

19. 434 U.S. at 84-95. For an explication of the doctrine, see note 9 *supra*.

20. 434 U.S. at 84-87. *See, e.g.*, O.D. 265, 1 C.B. 71 (1919) (board and lodging furnished to seamen in addition to cash compensation was supplied for the convenience of the employer, and therefore nontaxable); T.D. 2992, 22 C.B. 76 (1920) (in-kind items considered to be furnished for the convenience of the employer); O.D. 514, 2 C.B. 90 (1920) (payment of "supper money" to an employee who performed extra labor for the employer after regular working hours determined to be for the convenience of the employer and excludable from gross income); Mim. 5023, 1940-1 C.B. 14 (if living quarters or meals are furnished to an employee who is required to accept them in order to properly perform his duties, the test of convenience of the employer is satisfied); Mim. 6472, 1950-1 C.B. 15 (if the compensatory character of meals or lodging cannot be determined, they will be deemed to be furnished for the convenience of the employer).

21. 434 U.S. at 87-90. *See, e.g.*, Doran v. Comm'r, 21 T.C. 378 (1953) (maintenance engineer to a college who was required to occupy living quarters on the grounds of the school was not considered to have received compensation since his quarters were furnished for the convenience of the employer); Van Rosen v. Comm'r, 17 T.C. 834 (1951) (cash allowance for subsistence and quarters received by a shipmaster during the time the ship was being converted into a hospital ship, and during which time the master resided and dined at home, was held to be remuneration, and not for the convenience of the employer); Benaglia v. Comm'r, 36 B.T.A. 838 (1937) (manager of several hotels who resided at one of the hotels and ate all meals there at no cost to himself was determined to have not received compensation).

22. The House and Senate initially differed on the significance that should be attached to the convenience of the employer doctrine for the purpose of section 119. H.R. REP. No. 1377, 83d Cong., 2d Sess. (1954); S. REP. 1622, *supra* note 15. The House's proposal was that the meals should be excluded from gross income only if they were furnished at the place of employment and the employee was required to accept the meals as a condition of employment. The convenience of the employer doctrine was not mentioned in the House's version. The Senate's proposal referred to the doctrine, providing that "the basic test of exclusion is to be whether the meals or lodging are furnished primarily for the convenience of the employer (and thus excludable) or whether they were primarily for the convenience of the employee (and therefore taxable)." After conference, however, the House acquiesced in the Senate's version of § 119.

23. 434 U.S. at 93. Although the Court did not specifically indicate what it believed Congress intended the phrase to mean, it implied that the meaning is confined within the provisions of section 119.

meals and lodging from gross income while troopers cannot.[24] In doing so, the Court stated that equity arguments are of little force in determining inclusions and exclusions from gross income. Finally, the Court emphasized that the equity argument was considered and rejected by Congress in the repealing of section 120 of the Internal Revenue Code.[25]

In a dissenting opinion, Justice Blackmun, joined by Chief Justice Burger, conceded that cash meal payments do constitute income under section 61, but maintained that they should properly be excludable under section 119.[26] His dissent was partially based on the decision in *United States v. Morelan*,[27] which held that a subsistence allowance paid to a police patrolman was excludable from gross income under section 119.[28] Blackmun believed that since section 119 does not specifically speak in terms of in-kind rather than in-cash allowances, the statute is not intended to distinguish between them.[29] He concluded by agreeing with the taxpayer's argument that gross inequity exists in a situation which affords a substantial tax advantage to the military, but fails to give New Jersey state troopers a similar advantage.[30]

The *Kowalski* decision represents the Supreme Court's first attempt to deal with the problem of whether cash meal allowances paid to policemen constitute gross income under section 61, and if so, whether such payments are nonetheless excludable under section 119. In finding against the taxpayer, the Court primarily focused on the in-cash, in-kind distinction and the "convenience of the employer" doctrine.

---

24. 434 U.S. at 95-96. *See* Jones v. United States, 60 Ct. Cl. 552 (1925), which established the exclusion from gross income for cash allowances made to military personnel for subsistence and quarters.

25. 434 U.S. at 96. Section 120 as enacted allowed state troopers to exclude from gross income up to five dollars per day of subsistence allowance. This section was repealed four years after enactment. It is at least conceivable that the repeal of section 120 did not affect the application of section 119 to state troopers, since section 119 now applies in those situations to which section 120 had previously applied.

26. 434 U.S. at 97.

27. 356 F.2d 199 (3d Cir. 1966).

28. An alternative ground for the holding in United States v. Morelan was that the payment was deductible under I.R.C. § 162(a)(2) as an ordinary and necessary business expense. However, this alternative ground was later overruled by United States v. Correll, 389 U.S. 299 (1967), which restricted travel expense deductions for meal costs under § 162(a)(2) to overnight trips.

29. 434 U.S. at 97.

30. *Id.* at 98. *See* note 24 and accompanying text *supra*.

One of the major difficulties with the Court's analysis emanates from Justice Brennan's unexplained failure to consider the technical appendix of the Senate Report[31] in its totality. In concluding that only in-kind meals, and not cash allowances, were intended by Congress to be excludable from gross income, the Court correctly observed that the appendix states that section 119 applies to meals and lodging furnished in kind.[32] However, the Court overlooked the implications of the passage from the technical appendix which indicate that meals and lodging will be included in gross income only *to the extent that they represent compensation.* Consequently, the Court predicated its conclusion on the erroneous assumption that all cash payments are compensatory in nature, and refused to recognize a noncompensatory class of cash payments.[33]

The long history of the "convenience of the employer" doctrine evidences that not everything of value received by an employee is considered to be compensation,[34] and the very language of the technical appendix implies that Congress contemplated the creation of a noncompensatory class of cash payments for meals and lodging.[35] The Court attempted to explain away this qualifying language by concluding that it was meant to indicate that only meals deductible under section 162 were to remain unaffected by section 119.[36] However, the Court failed to substantiate its interpretation through any case law analysis, and offered no underlying rationale in support of its conclusion. In light of Congressional awareness of the history of the "convenience of the employer" doctrine, and since the technical appendix is specifically addressed to section 119, the absence of any reference to section 162 apparently indicates a deliberate omission by Congress. Therefore, contrary to the majority's view, the most reasonable interpretation of Congressional intent is that Congress intended to establish a noncompensatory class of cash payments that could be excluded under section 119.

---

31. *See* note 15 *supra.*

32. 434 U.S. at 84.

33. 434 U.S. at 93-94.

34. *See, e.g.,* Kowalski v. Comm'r, 65 T.C. 44, 66 (1975) (Sterrett, J., dissenting) (citing United States v. Barrett, 321 F.2d 911 (5th Cir. 1963)); Diamond v. Sturr, 221 F.2d 264 (2d Cir. 1955); Saunders v. Comm'r, 215 F.2d 768 (3d Cir. 1954)).

35. *See* Jordan, *Can Cash Payments to Employees be Excluded as Meals Under Section 119?* 45 J. TAX. 310, 11 (1976) [hereinafter cited as Jordan].

36. 434 U.S. at 94-95. Under I.R.C. § 162(a)(2), ordinary and necessary expenses for meals while away from home, and in the pursuit of a business, are deductible from gross income.

Another major difficulty with the *Kowalski* decision is that the Court obscured the rationale underlying the 1954 enactment of section 119. Prior to the 1954 enactment of section 119, exclusion of the value of meals and lodging from the taxpayer's gross income was based solely on the "convenience of the employer" doctrine.[37] Meals provided primarily for the employer's benefit, rather than the employee's, did not have to be included in the taxpayer's gross income.[38] The Internal Revenue Service interpreted the doctrine quite strictly, and included the value of meals in gross income if it considered them compensatory.[39]

Congress was apparently aware of the recurrent problems in the area of food and lodging,[40] and sought to clarify matters by enacting section 119. In construing this enactment, the Court unpersuasively concluded that Congress rejected the traditional "convenience of the employer" doctrine, and adopted as the exclusive rationale the business necessity theory.[41] Although Congress may have intended to overrule those prior decisions that had broadly construed the "convenience of the employer" doctrine, as the Supreme Court conceded in *Kowalski,*[42] Congress did not intend to completely abandon the doctrine.[43] Rather, the explicit language of section 119, with its specific reference to the "convenience of the employer", reflects Congressional approval of the doctrine, provided that its application is narrowly circumscribed to those instances where the meals and lodging are furnished for the convenience of the employer and the meals are furnished on the business premises of the employer.[44] Furthermore, by enumerating the requirements necessary for application of the "convenience of the employer" doctrine, Congress implicitly rejected the strict interpretation accorded the doctrine by the Internal Revenue Service.[45] The meaning attributed by the

37. *See* Jordan, *supra* note 35, at 310.

38. *Id. See, e.g.,* Diamond v. Sturr, 221 F.2d 264 (2d Cir. 1955) (psychiatrist at state medical hospital and housefather at state training school were not required to include value of food and lodging in gross income); Benaglia v. Comm'r, 36 B.T.A. 838 (1937) (manager of several hotels who resided and dined at one at no cost to himself was not required to include the value of the food and lodging in his gross income).

39. *See* Jordan, *supra* note 35, at 310.

40. *Id.*

41. 434 U.S. at 93.

42. *Id.* at 92.

43. *Id. See* note 22 and accompanying text *supra.*

44. *See* note 6 *supra.*

45. *See* Jordan, *supra* note 35, at 310.

Court to the enactment of section 119 is unsupported by any persuasive authority; on the other hand, the plain language of section 119 and the accompanying Senate Report[46] indicate that the "convenience of the employer" doctrine should remain the primary determinant for exclusion under section 119.[47]

Clearly, meal payments of the type provided in *Kowalski* are primarily for the convenience of the employer. The very nature of a patrolman's job requires that he be available at all times to answer calls, give directions, and respond to emergencies.[48] Thus, it is of paramount importance to the state that troopers remain within their specified areas at mealtime.[49] In those instances where the state furnishes meals, it is reasonable to require a trooper to eat in specific restaurants within his patrol area[50] so that he will be able to respond to a necessary call. The state could, therefore, set up a credit system in certain restaurants adjacent to the highway whereby the troopers could charge their meals and have the state pay the restaurants directly. Such a system would apparently conform to the *Kowalski* Court's requirements for exclusion under section 119, since a careful analysis of *Kowalski* reveals that troopers can receive tax free meal allowances when they are provided for the convenience of the employer and furnished in kind.

On the other hand, it is anomalous to disallow exclusion in those situations where the trooper is advanced a cash meal allowance, but is still required to eat in specific restaurants within his patrol area. The requirement that the trooper remain readily available to respond to calls is still primarily for the convenience of the employer;

---

46. *See* note 22 *supra*.

47. *See* Jordan, *supra* note 35, at 310.

48. 434 U.S. at 80. It is as important to the state and the public for a patrolman to dine in his assigned area and remain on call at all times as it is for a psychiatrist at a state hospital or a housefather at a state training school to be on the premises at all times, or for a hotel manager to remain at the hotel for meals and lodging. *See* Diamond v. Sturr, 221 F.2d 264 (2d Cir. 1955) (psychiatrist at state medical hospital and housefather at training school were not required to include value of food and lodging in gross income). *See also* Benaglia v. Comm'r, 36 B.T.A. 838 (1937) (manager of several hotels who resided at one and ate all meals there at no cost to himself was held to have received the meals for the convenience of the employer and their value was not required to be included in the taxpayer's gross income).

49. 434 U.S. at 79-80. The state changed from the meal station system to the cash allowance system because the former required troopers to leave their assigned areas for extended periods of time while going to the meal station.

50. *See, e.g.*, Keeton v. United States, 383 F.2d 429 (10th Cir. 1967) (Colorado highway patrolmen required to eat meals furnished by the state in a restaurant adjacent to the highway within their patrol area).

otherwise, he could often eat much less expensively in a restaurant outside of his patrol area. Thus, regardless of whether the state provides the meals in kind, or instead advances cash allowances, the meal allowances are still provided primarily for the convenience of the employer when the trooper is required to dine in specific restaurants within his patrol area. By creating the distinction between in-cash and in-kind meal allowances in these situations, the Court has exalted form over substance. Moreover, states seeking to circumvent *Kowalski* can set up a system that initially requires troopers to pay for their meals directly, but permits reimbursement for expended sums when an expense account is submitted, subject to a maximum allowance per day.[51] Such a system would alleviate the Court's concern with the failure of the existing system to require patrolmen to actually spend the cash allowance on meals.[52]

Because much of the reasoning used by the Supreme Court in dealing with the "convenience of the employer" doctrine and the in-cash, in-kind allowance distinction is less than convincing, the decision in *Kowalski* may not be the final pronouncement on this issue. If a case with slightly different facts is litigated in the future, the seemingly clear cut rule which requires that cash meal allowances paid to state troopers be included in gross income will probably not endure.

Marilyn Kay Josephs

51. *See* United States v. Barrett, 321 F.2d 911 (5th Cir. 1963) (patrolmen required to submit expense accounts and were limited to a maximum of $4.00 per day for meals).

52. 434 U.S. at 80.